FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Harris County, TX's Toll Road First Lien Revenue Refunding Bonds 'AA'; Outlook Stable

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Fitch Ratings - Chicago - 08 May 2024: Fitch Ratings has assigned a 'AA' rating to Harris County, Texas' (the county) approximately $950 million series 2024A junior first lien revenue refunding bonds. Fitch has also affirmed $1.9 billion of outstanding county toll revenue bonds at 'AA'. The Rating Outlook is Stable.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Harris County (TX) [Toll Roads]				
Harris County (TX) /Toll Revenues - First Lien/1 LT	LT	AA Rating Outlook Stable	Affirmed	AA Rating Outlook Stable
Harris County (TX) /Toll Revenues - Senior Lien/1 LT	LT	AA Rating Outlook Stable	Affirmed	AA Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

RATING RATIONALE

The ratings reflect Harris County Toll Road Authority's (HCTRA) essential road network in the large and economically solid Houston region with limited viable alternatives, which also drives strong traffic volume. The rating also reflects the authority's prudent financial management and history of strong and growing traffic and revenue performance. The authority shows robust financial metrics in Fitch's rating case, with a very high Fitch-calculated average 10-year gross senior and first lien debt service coverage ratio (DSCR) of 10.8x and 5.2x, respectively.

Fitch-calculated leverage (net debt to cash flow) is very low, with leverage turning negative on the senior lien in year five (2028) as available cash and reserves exceeds outstanding senior lien debt. Year five consolidated leverage on the first lien is 1.5x, reflecting the strong balance sheet liquidity that the authority maintains. These strengths are modestly offset by the authority's large capital plan, which will require additional debt issuances, and large annual subordinate transfers to the county.

While the authority's new toll policy is in effect as of fiscal 2024, which is expected to encourage the use of EZ-Tag users and reduce leakage costs, the authority has deferred the annual adjustment to toll rates every year since 2016. The annual adjustment factor to toll rates requires final approval from the commissioner's court, and the uncertainty of effecting future increases to tolls over a prolonged period suggest some political pressure on rate setting.

KEY RATING DRIVERS

Revenue Risk - Volume - High Stronger

Proven Resilience and Traffic Demand: HCTRA's toll road facilities provide vital transportation links with a strong monopolistic position in the Houston metropolitan area and an established and stable traffic demand profile. System traffic has increased nearly every year since fiscal 1998, supported by its continuing expansion in a large and rapidly growing metropolitan region. Toll rates are moderate, and historical elasticity of demand is low.

Revenue Risk - Price - Midrange (Revised from Stronger)

Rates Subject to Board Approval: The revision of the overall score to Midrange from Stronger reflects Fitch's view regarding the uncertainty regarding future toll rate increases. Despite the fact the current toll policy allows for an annual adjustment factor of the greater of CPI, or 2%, the authority has deferred the adjustments every year from 2016 to 2023, and the rates were left unchanged in the current fiscal period. Given the fact that the commissioner's court has the ability to review and adjust rates as deemed appropriate, a certain level of political considerations exist.

The authority's new toll rate policy reflects HCTRA's shift to a cashless system. Toll rates will be based on payment method, with two-axle EZ-Tag users receiving a 10% discount to encourage more EZ-Tag transponder penetration in the region. The policy is expected to reduce leakage and collection costs and provides the authority with flexibility to maintain a strong financial profile.

Infrastructure Dev. & Renewal - Stronger

Manageable CIP with Prudent Policies: HCTRA's large five-year capital improvement plan (CIP) is funded primarily by a mix of system operating revenues and bond proceeds. The authority adheres to strong capital planning policies that do not allow deferred maintenance, limit leverage to four to five times toll revenues, and makes use of significant pay-as-you-go funding resources. These strengths are offset by large annual subordinate transfers to the county that could be increased and would leave the authority more dependent on debt issuances for future projects.

Debt Structure - 1 - Stronger; Debt Structure - 2 - Stronger

Conservative Debt Structure: Fitch assesses the debt structure of both the senior and first lien bonds as stronger. The senior lien is now closed, with no future new money debt to be issued at the senior lien level. Fitch considers the first lien (junior) to be the operational senior lien for future debt issuances.

The overall capital structure consists of fixed-rate, fully amortizing debt. Debt service remains flat over the next 10 years, and then begins to decline throughout debt maturity. Structural features are strong overall, and the authority maintains cash and surety-funded debt service reserve funds (DSRF). While the Series 2024A First Lien Revenue Bonds are not being issued as participants in the first lien DSRF, Fitch still views the structure as adequate given the 2.0x DSCR trigger that would require the Authority to commence funding the Series 2024A DSRF.

Financial Profile

The authority benefits from strong balance sheet liquidity and high coverage ratios highlighted by growing cash balances and a robust rating case gross DSCR averaging 10.8x (1st Lien), 5.2x (2nd Lien), and 4.9x (3rd Lien) over the next 10 years (2024-2033). Rating case leverage metrics in year five (2028) are minimal with negative leverage on the 1st Lien, 1.5x on the 2nd Lien, and 1.6x on the 3rd Lien. Financial metrics weakened to some extent as part of the Series 2024A issuance, and may show further weakness due future debt issuances, but Fitch expects metrics to remain at levels consistent with the 'AA' rating category.

PEER GROUP

HCTRA's most comparable large expressway network peer is the Illinois State Toll Highway Authority (ISTHA; rated AA-/Stable). Although ISTHA also benefits from a large and economically diverse catchment area, its lower rating reflects weaker financial metrics as compared to HCTRA, including lower total debt service coverage of 2.0x and higher total leverage of 6.6x.

Another comparable large expressway peer is the Central Florida Express way (CFX; rated A+/A/Stable). CFX also benefits from a large and economically strong regional Orlando market. The lower rating on CFX compared to HCTRA reflects lower debt service coverage metrics, with rating case coverages of 1.9x on the senior and subordinate lien.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

--A material reduction in rating case combined (senior and first lien) DSCR to significantly below 2.5x for a prolonged period;

--A substantial increase in subordinate transfers from the system leading to reduced liquidity and higher dependence on debt to finance future CIP needs.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--Given the credit's already high rating level, a further upgrade is unlikely due to future investment together with sector-wide risks inherent to toll roads.

TRANSACTION SUMMARY

The authority expects to issue approximately $950 million in toll road revenue first lien revenue and refunding bonds (series 2024A). The proceeds will be used to pay certain costs related to projects in the capital plan, and to defease and refund the outstanding first lien commercial paper (CP) notes.

The series 2024A bonds will be on parity with the authority's outstanding first lien revenue bonds and CP program and are secured by a junior lien on gross toll revenues. The bonds are not being issued as a participant in the first lien DSRF. A separate account will be established within the first lien DSRF for the sole benefit of the series 2024A bonds. The series 2024A DSRF will be suspended for such time as the net revenues equal or exceed a 2.0x DSCR on all first lien obligations outstanding. In the event that the DSCR on all outstanding first lien obligations for any fiscal year are less than 2.0x, the County will be required to commence making deposits to the series 2024A DSRF per the indenture requirement of not less than 12 months aggregate debt service.

CREDIT UPDATE

Fiscal 2023 (9/30 FYE) traffic continues to remain strong, increasing 6% compared to fiscal 2022, reflecting the continued travel demand in Harris County driven by strong population growth. Combined gross DSCR on the senior lien and first lien remained robust, coming in at 6.0x for fiscal 2023. The authority's liquidity also remained strong, with a Fitch calculated 1,445 days cash on hand (DCOH) for fiscal 2023, well above the authority's internal policy to maintain DCOH of at least 730 days. Transactions for fiscal 2023 ended at 638 million, which beat Fitch's base case traffic projections of 619 million. Fiscal YTD 2024 traffic (September 23-March 24) is also trending positively, increasing 2% compared to the same period in the prior fiscal year.

Similarly, toll revenue performance has been strong, with a 11% increase in fiscal 2023 from the prior fiscal year. The authority waived administrative fees associated with violations during the pandemic, and is now beginning to increase enforcement which is had a positive impact on total revenues. Total revenues for the system exhibited further growth in fiscal 2023, increasing 15% over the prior fiscal year. This was driven by a large increase in interest income that the authority received. Total revenues ended fiscal 2023 at roughly $935 million, which exceeded Fitch's base case expectations of $862 million.

Operating expense continue to increase as the authority implements the transition to an all-electronic tolling (AET) system. Expenses increased 10% in fiscal 2023 over the prior fiscal year. Management expects costs to continue to rise until the transition is complete, which is anticipated to be in fiscal 2029.

The authority's current five-year capital improvement plan (fiscal years 2024 to 2028) that remains to be funded has a total cost estimate of $3.5 billion. The majority of budgeted costs are centered around two projects, the system-wide conversion to AET, and the Sam Houston Tollway (Ship Channel Bridge) project. These two projects have a combined estimated cost of roughly $3 billion. Both projects are currently underway, with the system-wide conversion to AET expected to be completed by fiscal year 2029, and the Sam Houston Tollway project expected to be completed by fiscal year 2029.

The authority is anticipating to continue using a mix of available surplus revenues, additional first lien bond issuances, and commercial paper, to fund the costs of the capital plan. A portion of the proceeds from the series 2024A bonds will be used to pay for certain costs related to these projects.

The authority continues to make mobility transfers of surplus revenues to the county to fund certain mobility projects that are not part of the toll road system. Transfers out to the county amounted to $369 million in fiscal 2023, and an additional $288 million authorized for fiscal 2024. Transfers out of the authority has increased over the past two fiscal years, however, Fitch takes comfort in the authority's debt management policy which imposes additional restrictions regarding the use of surplus revenues.

Fitch will continue to monitor the subordinate transfers from the authority. Fitch would view the potential weakening of liquidity resulting in an increased reliance on debt issuances to fund the CIP as credit negative. The county's fiscal prudence and restraint to date created the positive conditions under which the authority now benefits from robust debt service coverage, solid liquidity, low leverage, low toll rates, and a well-maintained system, all supporting the very high 'AA' category rating.

FINANCIAL ANALYSIS

The current financial metrics are extremely strong and are expected to continue under Fitch's base and rating cases. Due to the assets' performance through the first six months of fiscal 2024, Fitch projected 2024 traffic to grow about 2% over the prior fiscal year and then used the sponsor's long-term traffic growth rate assumptions thereafter. Fitch assumed no inflationary toll rate increases in fiscal year 2024, and then assumed 2% inflationary toll rate increases thereafter.

Initial O&M is derived from preliminary and budgetary figures, then later assumed to grow at above-inflationary rates beginning at 3.5%, reflecting increasing costs of the expanding system, and tapering down over time to 2% as system growth matures. Fitch assumes Interoperability Revenues remain at historical averages of 8% of total toll revenues. Under these assumptions, senior and first lien gross DSCR averages 11.7x (5.3x on a total debt basis) over the next 10 years (2024-2033), and year five (2028) net leverage turns negative on the senior lien, and reaches 1.5x on a total debt basis.

Fitch's rating case adopts the same assumptions as the base case for fiscal 2024 and then applies a -4% traffic stress in fiscal 2025 (2/3rds of Great Recession drop). Toll rate growth is assumed same as the base case. Traffic recovers to base case levels in FY2027 and base case projections are used from 2028 to 2054. Base case O&M projections are used for fiscal 2024, with an additional 50bps increase to reflect a more stressed opex environment. O&M is then projected to grow 50bps over the base case through the life of the debt. Under these assumptions, senior and first lien gross DSCR averages 11.6x (5.2x on a total debt basis) over the next 10 years, and year five (2028) net leverage turns negative on the senior lien, and reaches 1.5x on a total debt basis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

FITCH RATINGS ANALYSTS

Joseph Re
Associate Director
Primary Rating Analyst
+1 312 368 5461
joseph.re@fitchratings.com
Fitch Ratings, Inc.
One North Wacker Drive Chicago, IL 60606

Ben Munguia
Director
Secondary Rating Analyst
+1 512 215 3732
ben.munguia@fitchratings.com

Seth Lehman
Senior Director
Committee Chairperson
+1 212 908 0755
seth.lehman@fitchratings.com

MEDIA CONTACTS

Sandro Scenga
New York
+1 212 908 0278
sandro.scenga@thefitchgroup.com

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

Infrastructure & Project Finance Rating Criteria (pub. 17 May 2023) (including rating assumption sensitivity)

Transportation Infrastructure Rating Criteria (pub. 18 Dec 2023) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

GIG AST Model, v1.4.1 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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Harris County (TX)	EU Endorsed, UK Endorsed

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch's website.

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